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Supreme Court of the United States

OCTOBER TERM 1951

No. 179

OSTERMAN & HUTNER, GOLDMAN SACHS & CO., GRAHAM-NEWMAN CORPORATION, NEWMAN & GRAHAM, and ABRAHAM & CO.,

Petitioners,

against

GUARANTY TRUST COMPANY OF NEW YORK, as Trustee under the First Consolidated Mortgage Deed of The Rio Grande Western Railway Company, dated April 1, 1899, JULIUS KLOSTERMAN, THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee under the Refunding and Improvement Mortgage of The Denver and Rio Grande Western Railroad Company's General Mortgage, dated February 1, 1924, CITY BANK FARMERS TRUST COMPANY, as Trustee under THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY'S GENERAL MORTGAGE, dated February 1, 1924, THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY, and HAROLD S. BARD,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE APPELLATE DIVISION OF THE SUPREME COURT FOR THE FIRST DEPARTMENT OF THE STATE OF NEW YORK.

PHILIP B. JACKSON,
Counsel for Petitioners.

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE APPELLATE DIVISION OF THE SUPREME COURT FOR THE FIRST DEPARTMENT OF THE STATE OF NEW YORK AND BRIEF IN SUPPORT THEREOF

Petitioners, Osterman & Hutner, et al., intervenors below, as holders of approximately 20% of the Refunding and Improvement Mortgage Bonds of the Denver & Rio Grande Western Railroad Company, pray that a writ of certiorari issue to review the order of the Appellate Divi-

sion of the Supreme Court of the First Department of the State of New York, entered on the 27th day of February, 1951. Leave to appeal from said order, sought by petitioners, was denied by the Court of Appeals of the State of New York, on June 1, 1951. The order of the Appellate Division affirmed an order of the Supreme Court of the State of New York, entered in the office of the Clerk of the County of New York, on the 14th day of September, 1950, fixing certain allowances and authorizing payment thereof.

Opinion Below

The only opinion below is the opinion of the New York Supreme Court (R. 179), not reported. The order of affirmance of the Appellate Division of the Supreme Court (R. 197) and the order of denial of leave to appeal by the Court of Appeals (R. 203) were without opinion.

The opinion of the New York Supreme Court, denying petitioners' intervention discusses the Federal questions raised by petitioners (R. 185). The order denying intervention was modified on appeal by the Appellate Division of the Supreme Court for the First Department to the extent of granting the application to intervene for the purpose of the appeal (R. 200).

Jurisdiction

The order of the Appellate Division of the Supreme Court for the First Department of the State of New York, was entered on February 27, 1951. The Court of Appeals of the State of New York, by order dated June 1, 1951, denied petitioners' application for leave to appeal to that Court. The jurisdiction of this Court is invoked under Section 1257(3) of the 1948 Revised Judicial Code, Title 28, U. S. C. Sec. 1257(3).

The Federal questions determinative of this case were raised by petitioners' motion to intervene for the purpose of objecting to the applications for allowances and, to the extent necessary, for the purpose of appealing from an order that might be entered granting allowances (R. 18-32). As will be shown, the state courts, in making their decisions, necessarily passed upon the Federal questions and in a manner which conflicts with the decisions of this Court in *Brown* v. *Gerdes*, 321 U. S. 178, and *Leiman* v. *Guttman*, 336 U. S. 1.

Portion of the Constitution and Statutes Involved

The relevant portion of the Constitution is Article I, Sec. 8(4). The statutes involved are Section 1334 of the 1948 Revised Judicial Code, Title 28, U. S. C. and Sec. 77(c)(12) of the Bankruptcy Act, Title 11, U. S. C., Sec. 205(c)(12). The relevant portion of the Constitution and of the Statutes are reproduced in the Appendix hereto (p. A-1).

Questions Presented

In the light of the decisions of this Court in *Brown* v. *Gerdes*, 321 U. S. 178, and *Leiman* v. *Guttmann*, 336 U. S. 1:

When under a plan of reorganization, adopted and approved in a proceeding pending in the Federal Court under Section 77 of the National Bankruptcy Act, it becomes necessary to institute and maintain a subsequent judicial proceeding * and the consummation decree thereafter entered by the Federal District Court requires that allowances for compensation for services to be rendered in such subsequent judicial proceedings be allowed by the District Judge and be paid by the reorganized railroad company, as expenses incurred in connection with the proceedings or the Plan.

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* "The judicial proceedings which must be brought by the Trustee of the First Consolidated mortgage * * *" *R. F. C.* v. *D. & R. G. W. R. Co.*, 328 U. S. 495, 530.

May a state court, in which the parties to the reorganization proceedings have instituted such subsequent proceedings, and may such parties and such reorganized railroad company thereafter, over the objection of bondholders affected, disregard the provisions of such consummation decree, i.e.,

(a) May such parties thereafter apply to such state court for allowances for such subsequent services and may such state court entertain such applications?

(b) May such reorganized railroad company request such state court not to charge such allowances to it but to the proceeds of the collateral affected by such subsequent proceedings?

(c) May such state court fix the amount of such allowances and order the same paid, not by the reorganized railroad company, but by application of such proceeds of the collateral security?

(d) May such parties accept such payment?

Statement

The petitioners are the holders of approximately 20% of the Refunding and Improvement Mortgage bonds of the Denver and Rio Grande Western Railroad Company.

The respondents are, in the main, the Indenture Trustees and their counsel, who represent the holders of three formerly outstanding bond issues of the Denver and Rio Grande Western Railroad Company, the subject of Section 77 reorganization proceedings in the United States District Court for the District of Colorado.

The present issue involves the right of respondents to seek, and the jurisdiction of the New York state court to grant allowances of compensation to respondents and others and to order the same paid out of the proceeds of collateral held by respondents as security for the payment of their respective bond issues. Such compensation was

sought for services rendered in proceedings brought in the State Court by respondents to determine the respective rights of the holders of their three issues of bonds in stock of Utah Fuel Company, pledged, with other collateral to secure payment of the obligations of the railroad company. The Federal Court had previously taken jurisdiction of the collateral in the pending 77 proceedings affecting the railroad and had stayed any action thereon by the respective respondent-trustees.

The plan filed by the railroad company in the 77 proceedings and approved by the Federal Courts had cancelled the liens of the respective bond issues on all collateral except the pledged stock of the Utah Fuel Company; as to that the plan "did not in any way change or affect existing rights in the collateral" * and this treatment necessitated the subsequent judicial proceedings to determine the respective deficiencies and consequent priorities and claims of the bond issues against the Utah Fuel stock.† After this Court so held, the District Court made its consummation decree which provided:

> "The Reorganized Company shall pay to each of said trustees reasonable compensation for services rendered and reimbursement for expenses incurred by it, including attorneys' fees, in securing an adjudication of its interests or claims, if any, as trustees, in and to said stock of the Utah Fuel Company, in such amount as may hereafter be approved and allowed by this Court" (Par. 19, R. 68).
>
> * * * * * *
>
> "The Reorganized Company shall also pay, in such amounts as * * * shall hereafter be allowed by this Court * * * all other expenses and costs of the administration of these proceedings, including allowance of fees or compensation for services and reimbursement of expenses * * * hereafter rendered or incurred in connection with these proceedings or the

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* *R. F. C.* v. *Denver and Rio Grande W. R. Co.*, 328 U. S. 495 530.

† Ante, footnote p. 3.

> Plan by or on behalf of parties to these proceedings * * * all compensation for services rendered and all expenses incurred by the trustees now acting under the mortgages referred to in paragraphs * * * (18) [the mortgages involved in the present suit] of this order which would have been secured, respectively, by the liens of such mortgages, if such mortgages had not been satisfied, cancelled, and released by, or pursuant to, this order, shall be deemed to be expenses incurred in connection with these proceedings or the Plan" (Par. 7, R. 62, 63).
>
> * * * * * * *
>
> "The Court hereby reserves jurisdiction to allow fees or compensation for services and reimbursement for expenses * * * hereafter rendered or incurred in connection with these proceedings or the Plan * * * " (Par. 50, R. 77).

Immediately after the entry of the Consummation Decree, the respondent Trustee of the First Consolidated Mortgage instituted the state court proceedings and, in consequence of a judgment entered therein, the collateral, the Utah Fuel stock, was sold and the proceeds allocated to the respective bond issues in the order of the respective priorities of lien, as found by the state court decree.

After payment to the First Consolidated Mortgage bondholders of the amount of their adjudged deficiency, there remained an overplus of $800,000, which became payable to the Refunding and Improvement Mortgage bondholders, under the terms of the state court findings. However, in lieu of making application for allowances of compensation to the District Judge under the terms of the consummation decree, the respondents, the indenture trustees and their counsel, made application to the state court judge for such allowances of compensation payable from the overplus of the proceeds of sale of the collateral otherwise payable to the Refunding and Improvement Mortgage bonds. The state court judge, over the objection of these petitioners, made an order granting to respondent-trustees and their counsel and to counsel for respondent bondholder-intervenors allowances aggregating $266,427 and the same

were paid by the respondent Trustee for the First Consolidated Mortgage to itself and the other claimants.

From two orders, one denying these petitioners leave to intervene for the purpose of objecting to such allowances and appealing from any order granting the same, and the second, the order granting such allowances, these petitioners appealed to the Appellate Division of the Supreme Court of the State of New York. That Court affirmed the order denying the allowances; it modified the order denying intervention by granting leave to intervene for the purpose of taking the appeal. Application for leave to appeal to the New York Court of Appeals was denied by that Court.

Petitioners urged in the courts below that under Federal Bankruptcy law and the provisions of the Consummation Decree the state court was without jurisdiction to grant allowances and direct a contrary method of payment. The state courts' orders necessarily involved a consideration and rejection of this contention.

Petitioners, having exhausted their state court remedies, now petition this Court for a writ of certiorari to review the order below.

Reasons for Granting the Writ

The determination below in this case constitutes and approves a direct disregard and express violation of

(1) A decree of a Federal Court in a Federal reorganization proceeding, concurred in by the parties thereto, standing unchallenged and unreversed;

(2) The exclusive jurisdiction of the Federal courts:

(a) to control reorganization fees and expenses and

(b) "to police the return which all securityholders obtain from reorganization plans." *

* *Leiman* v. *Guttman*, supra, p. 8.

(3) The determination below is in direct conflict not only with the decisions of this Court but also with the decision of the Federal Court of Appeals for the Third Circuit in *New York Trust Co.* v. *New York & Greenwood Lake Ry. Co.*, 156 F. 2d 701, where comparable and apposite factual and legal situations existed.

ARGUMENT

The Federal jurisdiction to grant compensation under Section 77 and other Federal reorganization statutes and to fix allowances therefor is exclusive.

(*Brown* v. *Gerdes*, supra;
Leiman v. *Guttman*, supra.)

There can be no challenge of the basic fact that by its Consummation Decree,* entered in the reorganization proceeding in which the Federal Court had taken jurisdiction of the *res* and to which jurisdiction the Indenture Trustees and their counsel had submitted fully and unqualifiedly, and in which they had litigated questions respecting the *res* (including the disposition of the collateral, the Utah Fuel stock) †, the Federal Court had

(1) Adjudicated

(a) that the services to be rendered in the subsequent judicial proceedings should be "deemed to be ex-

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* Entered by the Court with the concurrence of these respondents, i.e., the Indenture Trustees, their counsel and the reorganized railroad.

† The Trustee of the First Consolidated Mortgage had applied to and had received from the Federal Court compensation for services in the reorganization proceeding and expressly in connection with the proposals respecting the Utah Fuel Collateral (242 ICC 629, 640, 641).

penses incurred in connection with these proceedings or the Plan" (Decree, Par. 7, R. 63);

(b) that allowances of compensation for the subsequent judicial proceedings should be "approved and allowed by (it) this Court" (id., Par. 19, R. 68);

(c) that the "Reorganized Company shall pay to each of said trustees reasonable compensation * * * including attorneys' fees, in securing an adjudication * * * in and to said stock of the Utah Fuel Company (id.); and

(2) Expressly reserved and retained jurisdiction to fix and allow such compensation (id., Par. 50, R. 77).

The Federal decree was concurred in by these respondents, the Trustees, their counsel, and their bondholders, no objection was taken thereto; it stands unchallenged and unreversed.

Its adjudication binds and estops these respondents from seeking its violation.

And its reservation of jurisdiction precludes any attempt to exercise jurisdiction, whether in accordance or in violation of its terms, by a State court.

The only field of possible dispute that is permitted in these allowance cases by the decisions of this Court in *Brown* v. *Gerdes* (supra) and *Leiman* v. *Guttman* (supra) is whether the Federal Reorganization Court has jurisdiction. Once that premise—here beyond dispute—is found, the conclusion that no state court exercise of jurisdiction is possible, becomes inevitable and inescapable.

The reasons which dictate the rule—enunciated with clarity and cogency in *Brown* v. *Gerdes* and *Leiman* v. *Guttman*—find emphatic documentation here. As provided by Section 77, the reorganized railroad company took the assets of its predecessor company subject to payment of all allowances made by the District Court for reorganiza-

tion services necessarily rendered by parties and counsel. As required by statute, as in all bankruptcy reorganizations, the distributions to creditors were and are to be free of such charges; they are net and are not to be subjected to claims for reorganization services rendered. The consummation decree was here made in terms which expressed and sought to consummate the Congressional intent. The proceeds of the collateral were thus freed so they might be distributed without deduction to these bondholders. The Indenture Trustees and their counsel were fully protected; the consummation decree provided for their compensation as the statute contemplated and required. Yet by this transgression of the express terms of the decree, the $800,000 available to these Refunding and Improvement Mortgage bondholders for their deficiency exceeding $16,000,000, is to be charged with a deduction of $266,427, for allowances of compensation made in denial and violation of the terms of the decree and the underlying statute and without and flaunting the control of the reorganization court. Here, as a result of this state court determination, the control of compensation is not only taken from the Federal Court but the terms of a plan are changed and violated and the distribution to creditors reduced by extramural allowances. The prevention of each of these abuses is an expressed reason for the rule enunciated by this Court in *Brown* v. *Gerdes* and *Leiman* v. *Guttman*. Their presence here demonstrates the need for the rule and its instant application.

The respondents in the courts below have sought to avoid the effect of these controlling decisions of this Court by pointing out that the title to the Utah Fuel stock was not in the old railroad company.

Aside from the fact that the railroad company had a definite interest in the accruals from the Utah Fuel stock (R. 101), which was only cut off by the final plan, the question of title to the Utah Fuel stock is here immaterial,

for it is not to be questioned that the reorganization court took jurisdiction of all collateral held by the bondholders (including the Utah Fuel stock); that, through their Indenture Trustees, the bondholders filed and submitted their claims, liens and collateral to the District Court, and unequivocally submitted themselves to its jurisdiction;* they litigated in the reorganization proceeding the manner of the disposition of the collateral and, specifically, the disposition of the Utah Fuel stock (233 ICC 515, 538, 542, 573); the Trustees sought and received compensation for services rendered in the Reorganization Court and expressly based such claims in part upon services rendered with respect to the disposition of the Utah Fuel stock in the reorganization proceeding and reorganization plans concerning the same and its disposition (242 ICC 629, 640, 641).

But what, of course, is all-important is that the Federal Court expressly adjudicated, in and by the Consummation Decree, that compensation for services to be rendered in the subsequent judicial proceedings affecting the Utah Fuel stock, should be deemed expenses incurred in connection with the "proceedings or the Plan" and should be paid for out of the reorganization funds entrusted to, and by the reorganized railroad company—and the parties concurred in and acted pursuant to the decree up to the final point where they sought to disclaim it by applying to the State Court for allowances.

What is equally of paramount importance is that the Federal Court took and reserved jurisdiction to award these allowances as part of the expense of reorganization and that by reason of rules of res judicata and of estoppel that adjudication cannot be here questioned or challenged (*Chicot County Drainage Dist.* v. *Baxter State Bank*, 308

* The argument of counsel for intervening bondholders that they were not parties bound by the reorganization decree has no weight: their bondholder clients were parties, and the theory of allowance reckons only with reimbursement of the client (*Trustees* v. *Greenough*, 105 U. S. 527).

U. S. 371) and once jurisdiction is found in the Federal Court, that jurisdiction is exclusive under the decisions of this Court.

And what is here of grave public importance is that the rule of exclusive Federal jurisdiction laid down by this Court to implement the protection Congress sought to afford creditors by the revisions of the bankruptcy act against the rapacities of indenture trustees and counsel not selected by them, may not be whittled away by resort to complaisant local Judges or by fine and technical factual distinctions.

Here, when the greater part of the collateral of the bondholders was taken from them by the reorganization court and was no longer available to them upon a foreclosure, *ex* the reorganization, fairness and justice dictated application of the bankruptcy rule that the costs of the foreclosure should be deemed a cost of and should be borne by the general reorganization fund (to which, in the reorganization proceedings, each class of creditor had made its contribution) and not be charged to a minor portion of the collateral, fortuitously or unfortuitously remaining by virtue of the structure of the plan. Fairness and reorganization practice required that the distribution to creditors by way of substitute collateral and the proceeds of sale of the old collateral be net, freed of any part of the reorganization expense. This the Statute and the Federal Court sought to effect under the rule of protection laid down by this Court and it is manifest that justice and equity and the necessity of exercise of the rule are unaffected by any technical argument of where the underlying equity in the Utah Fuel stock lay.

While not daring to deny the jurisdiction of the reorganization court or the plain intendment of the rule adopted by this Court that makes that jurisdiction exclusive, re-

spondents yet managed to argue below that the Consummation Decree left open to the respondents a voluntary choice—an option—to seek compensation elsewhere than through the Federal Court from the reorganized railroad and this despite the express Federal adjudication "that the reorganized company shall pay * * * such amount as may hereafter be approved and allowed by this Court" (Decree, Par. 19, R. 68).

So respondents made the tortuous argument that they may have recourse to the proceeds under the powers granted to them by the Indenture, although they concede, as they must, that the Consummation Decree cancelled the Indentures except insofar as it was necessary to leave the Trustees with power to prosecute the subsequent legal proceedings.

Here, again, we find the injustice of seeking to charge a fraction of the collateral after the major portion of the collateral has been released by the decree of the reorganization court. In making this contention, the Indenture Trustees seem to lose sight of the fact that, at least by modern *mores,* the provisions of an Indenture that permit a Trustee to have compensation for the discharge of his trust duties out of the general funds of the debtor are not designed solely for the benefit of the Trustee; they are inserted primarily for the benefit of the *cestuis.*

These Indentures, as was customary, provided that the primary liability for the expenses of foreclosure should be that of the railroad and that the proceeds of the collateral should be secondarily liable for expenses arising from default. The plan had freed the bulk of the collateral from its secondary liability for expenses incurred by reason of the default; the consummation decree properly freed the remainder and had the railroad assume its primary obligation for both. Nothing else would have been justified, in equity or under bankruptcy practice. The bondholders were entitled to their avails, whether under the statute or under the pledge, free of the cost of reorganiza-

tion or foreclosure. They were entitled to have that expense paid out of the general and available funds of the railroad, both by the terms of the statute and of the pledge. They were entitled to that—as against the railroad—and as against their Trustees. What they were compelled to pay their Trustees under the pledge was a charge for which they were entitled to reimbursement from the railroad. The reorganization decree, in disposing of the underlying liabilities of the railroad, recognized its primary liability under the Indenture for the expenses of foreclosure and properly treated them as part of the expense of reorganization. The Federal Court, in recognition of this, properly adjudged that the railroad should pay these expenses directly, upon application of the Trustees. The Trustees cannot contend, in the face of that adjudication, justified and required by statute and their Indenture, that they may (at their option) violate and transgress this right of their *cestuis*.

CONCLUSION

Wherefore, for the reasons stated, the petition for certiorari should be granted.

Respectfully submitted,

PERCIVAL E. JACKSON,
Counsel for Petitioners.

Dated, June 29, 1951.

APPENDIX

THE PORTION OF THE CONSTITUTION

Article I, Sec. 8(4):

> "*Sec. 8* [*Powers of Congress*] The Congress shall have power * * * (4) To establish * * * uniform Laws on the subject of Bankruptcies throughout the United States."

STATUTES INVOLVED

Sec. 1334 of the 1948 Revised Judicial Code, Title 28, U. S. C.:

> "1334. *Bankruptcy matters and proceedings.* The district courts shall have original jurisdiction, exclusive of the courts of the States, of all matters and proceedings in bankruptcy. (June 25, 1948, c. 646, § 1, 62 Stat. 931.)"

Sec. 77(c)(12) of the Bankruptcy Act, Title 11, U. S. C. § 205:

> "(12) *Compensation for services.* Within such maximum limits as are fixed by the Commission, the judge may make an allowance, to be paid out of the debtor's estate, for the actual and reasonable expenses (including reasonable attorney's fees) incurred in connection with the proceedings and plan by parties in interest and by reorganization managers and committees or other representatives of creditors and stockholders, and within such limits may make an allowance to be paid out of the debtor's estate for the actual and reasonable expenses incurred in connection with the proceedings and plan and reasonable compensation for services in connection therewith by trustees under indentures, depositaries and such assistants as the Commission with the approval of the judge may especially employ."